IV. THE PUBLIC PROPERTY RATIONALE

42. A final justification offered for retaining the newspaper-television cross-ownership rule is government ownership of the electromagnetic spectrum. The public property rationale prompts two responses. First, the system of public ownership and private use of the spectrum established in the Communications Act is considerably more subtle than the label "public ownership" suggests. Those invoking the public property argument must address the precise nature of the government's property interest in the spectrum and how it relates to the broadcaster's limited property interest created by statute during the license term. Second, the Commission's policies recognize and promote highly specialized, private investment by a broadcaster that is complementary to his receipt of a license. The public property rationale surely cannot extend to such private investment. To the contrary, reliance on the public property rationale would harm the public interest if it were to discourage such broadcaster investment in private property.

A. *The Statutory Extent of Public Ownership of the Spectrum*

43. By its enactment of the Radio Act of 1927, Congress in effect decided to make the spectrum a public resource, license its use, and declare that the licensee acquires no property interest in the frequency. The D.C. Circuit quickly confirmed that the legislation created no property right in the licensed frequency, ruling in 1932 in *Trinity Methodist Church, South* v. *FRC* that the Federal Radio Commission's refusal to renew a license could not constitute a taking of property under the Fifth Amendment, because there was no private property to be taken.[47]

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47. 62 F.2d 850, 853 (D.C. Cir. 1932). The case is frequently cited as *Shuler*, as in Part V of this affidavit, because of the evangelist broadcaster by that name who controlled the station.

44. Similarly, the broadcast licensing provisions of the Communications Act of 1934 begin in section 301 with the statement that their purpose is "to maintain the control of the United States over all the channels of radio transmission; and to provide for the use of such channels, but not the ownership thereof, by persons for limited periods of time, under licenses granted by Federal authority, and no such license shall be construed to create any right, *beyond the terms, conditions, and periods of the license.*"[48] Elsewhere, in section 309(h), the act requires that a "station license shall not vest in the licensee any right to operate the station nor any right in the use of the frequencies designated in the license *beyond the term thereof.*"[49] In addition, section 304 provides: "No station license shall be granted by the Commission until the applicant therefore [*sic*] shall have signed a waiver of any claim to the use of any particular frequency or of the electromagnetic spectrum as against the regulatory power of the United States because of the previous use of the same, whether by license or otherwise."[50] Thus, a condition placed on the grant of a license is that the broadcaster relinquish the right to assert a claim of adverse possession over a frequency.

45. By 1940, in its first pronouncement on the Communications Act of 1934, the Supreme Court echoed the D.C. Circuit's brief analysis of the property question in the *Trinity Methodist Church* case, stating in *FCC* v. *Sanders Brothers Radio Station*: "The policy of the Act is clear that no person is to have anything in the nature of a property right as a result of the granting of a license."[51] By 1948, however, the D.C. Circuit retreated from its emphatic denial

48. 47 U.S.C. § 301 (emphasis added).
49. *Id.* at § 309(h) (emphasis added).
50. *Id.* at § 304.
51. 309 U.S. 470, 475 (1940).

of the existence of property rights, stating in *L.B. Wilson, Inc.* v. *FCC* that under the Communications Act a broadcaster has "a private right or interest in a station licensee while his license is outstanding,"[52] even if it is not an ownership interest:

> That private as well as public interests are recognized by the Act is not to be doubted. While a station license does not under the Act confer an unlimited or indefeasible property right—the right is limited in time and quality by the terms of the license and is subject to suspension, modification or revocation in the public interest—nevertheless the right under a license for a definite term to conduct a broadcasting business requiring—as it does—substantial investment is more than a mere privilege or gratuity. A broadcasting license is a thing of value to the person to whom it is issued and a business conducted under it may be the subject of injury . . . . [D]ecisions of the Supreme Court . . . support these statements and . . . provisions of the Communications Act itself . . . recognize that a broadcasting license confers a private right, although a limited and defeasible one.[53]

That reasoning is more cogent than the Supreme Court's oblique sentence quoted earlier from *Sanders Brothers*. Suppose a lessee of office space assigns his unexpired lease. Simply to recognize that, for a limited period of time, the lessee holds a valuable asset that he may convey to another does not imply that he owns the building that he leases or the ground on which it stands. To the extent that the lessee "owns" a property interest, it is something vastly inferior to a fee simple. If the lessee could convey a fee simple rather than an unexpired leasehold, he could obviously fetch a higher price. Similarly, a broadcaster could fetch a higher price for the sale of his station if he could convey a fee simple in the frequency on which it operates rather than merely a defeasible license awarded by the FCC to use that frequency for a specified purpose for a term of years.

46. As an elementary matter of property law, *Wilson* is inconsistent with *Sanders*

52. 170 F.2d 793, 798 n.5 (D.C. Cir. 1948).
53. *Id.* at 798 (citations omitted).

Brothers and *Trinity Methodist Church*. It is contradictory to say in *Sanders Brothers* that the Communications Act does not create "anything in the nature of a property right," and then to say in *Wilson* that the statute "confers a . . . limited and defeasible" private right. By the plain language of the Communications Act, the Supreme Court misspoke in *Sanders Brothers* to the extent that it intimated that the grant of a license does not create *any* kind of property interest. Section 309(h) states only that a licensee shall not confer any rights "*beyond the terms thereof.*"[54] Plainly, a statutory provision stating that a station license does not confer any right to use a particular frequency after the present license term expires presupposes that, during the term of that license, a licensee *does* possess some cognizable property interest. It would be far-fetched to suppose, in the alternative, that section 309(h) manifested Congress' concern that a nonexistent property right during the license term would turn into a valid property interest after that license term had expired. Because the Communications Act does create, at a minimum, a defeasible property interest in the *use* of a frequency, the Supreme Court's statement in *Sander Brothers* that a broadcast license lacks "anything in the nature of a property right" is simply overbroad.

47. In practical terms, however, it matters little to correct the popular misconception that the Communications Act confers to the licensee during his license term no constitutionally protected property interest, because relatively few actions by the FCC to confiscate a broadcaster's license occur during the term of the license through the vehicle of a revocation proceeding under section 312 of the Communications Act.[55] To the contrary, most confiscatory

54. 47 U.S.C. § 309(h) (emphasis added).
55. 47 U.S.C. § 312.

actions occur after the expiration of a license term, during the license renewal process, when the FCC and petitioners adverse to the licensee face much lower procedural hurdles to disqualify a renewal applicant than they do a licensee in a revocation hearing. In a revocation proceeding, "both the burden of proceeding with the introduction of evidence and the burden of proof shall be upon the Commission."[56] In a renewal proceeding, however, both evidentiary burdens are on the renewal applicant.[57]

B. *Economic Rents, Asset Specificity, and Licensure of the Spectrum: Is Public Ownership of the Spectrum Irrelevant?*

48. Apart from the express provisions of the Communications Act granting the licensee an interest in the *use* of a frequency during the license term, broadcast regulation embodies a system of investment-backed expectations that resemble de facto property rights upon which both broadcasters and the Commission rely. Those de facto property rights arise from a broadcaster's specialized investment in his station and his economic expectation that he will be able to convey to others the income stream associated with his license and the investments made pursuant to it.

1. *Economic Rents in Broadcasting*

49. A commercial broadcaster sells audiences to advertisers.[58] He profits by the amount that his advertising revenue exceeds the cost of assembling and transmitting programs free of charge to those audiences. The market price of an advertising slot depends on how many

56. *Id.* § 312(d).
57. *Id.* § 309(e).
58. I do not analyze noncommercial broadcasting in this affidavit.

"impressions" it imparts on listeners or viewers—the broadcast analogue to newspaper circulation. There are fixed costs to secure the rights to finished programming, costs analogous to "first negative" costs in the motion picture business or "first copy" costs in the newspaper business. For a given amount of radiated power, the marginal cost of providing a program to one additional viewer or listener is zero because, on the demand side, one person's consumption of a broadcast does not preclude or diminish another person's ability also to consume the broadcast, unlike the rival consumption that attends most consumer goods, such as cars or hamburgers.[59] Thus, there are significant economies of scale in both consumption and program production.

50. There is, however, a problem of rival use of the essential input for distributing broadcast programming, because one station's use of a specific frequency within a geographic area precludes its use by another, lest both stations end up with a garbled signal. A station can increase its audience size by increasing its power, assuming that the physical properties of its service contour permit. But at some scale of signal coverage a broadcaster can expand his audience size only by reducing the audience size of another broadcaster on the same frequency in a different locale. Thus, because the distribution of broadcasts is mutually exclusive on any given frequency, and because a profit-maximizing broadcaster has the incentive to enlarge his service contour until it begins to encroach on the contour of a neighboring broadcaster, it is necessary to establish a system to allocate and enforce rights to use the spectrum.

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59. *See, e.g.*, OWEN, *supra* note 28, at 16–18; BRUCE M. OWEN & STEVEN S. WILDMAN, VIDEO ECONOMICS 3–4 (Harvard University Press 1992).

2. *Asset Specificity and Government Licensure*

a. *Ownership and Expectation*

51. The decision by Congress to license the use of broadcast frequencies, rather than simply sell those frequencies or lease them for a term of years like a piece of government land, has had pervasive implications for the regulation of the structure and content of broadcasting and the daily business conduct of broadcasters. While emphasizing that the air waves belong to the public and not the broadcasters licensed to use them and entitled to transfer their stations for value, the FCC has nonetheless given licensees many accoutrements of ownership. The relevant question, however, is not whether there exists a private ownership right in the electromagnetic spectrum. As shown in the previous section, the short answer to that question is that, by statute, a limited right of *use* does exist. But the value of a broadcast station depends not so much on that limited statutory right as it does on the expectation that the station's license will continue to be renewed in perpetuity, regardless of who holds it during its current license term. In what might be regarded as the inverse of the Coase Theorem, the greater the transactions costs for terminating one's use of a licensed frequency, the more that person's use merges with an absolute property right akin to a fee simple.[60]

52. Although the Communications Act precludes the private ownership of broadcast frequencies, it does not preclude the FCC from permitting a licensee to keep, by assigning his license, all or part of the capitalized value of the expected net cash flows associated with the license. Section 310(d) deprives the Commission of the discretion to withhold approval for a

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60. *See generally* J. Gregory Sidak, *The Inverse Coase Theorem and Declarations of War*, 41 DUKE L.J. 325 (1991); J. Gregory Sidak, *The Line-Item Veto Amendment*, 80 CORNELL L. REV. 1498 (1995).

license assignment to a qualified licensee on the grounds that someone else would give better service.[61] It is only the initial license award for an allotted channel—and in the extraordinary event of revocation or nonrenewal—that the Commission has occasion to restrain the alienability of a broadcast frequency and allocate previously assigned licenses by comparative selection. Section 310(d) precludes the FCC from considering the comparative qualifications of assignees, and the FCC routinely approves assignments by licensees in good standing to qualified persons without restricting the consideration given in exchange. Thus, the FCC has permitted a licensee in good standing, by selling his station, to capture the capitalized value of the expected net cash flow of its present license term—as well as any capitalized value that the marketplace attributes to the expected net cash flow for future license terms.

53. In other words, there is a regulatory presumption that, after the initial grant of a license, a broadcast station should be freely alienable in the marketplace.[62] There is a commercial expectation, reflected in the prices that broadcasters pay to acquire licensed stations and in the amounts that they subsequently invest in them, that one who acquires a license will keep it until he sees fit to dispose of it by sale. Therefore, the value of an FCC license depends not only on the expected net cash flow that it will generate for its owner during the existing term, but also on whether the licensee is free to transfer the license to another qualified person. Although a license exists as a legal thing only for a term of years, denial of renewal has the effect of denying the licensee the value of an expected net cash flow of unlimited duration.

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61. 47 U.S.C. § 310(d). In 1989, the FCC repudiated its "Wichita-Hutchinson doctrine," which had precluded the assignment of a broadcast license to a transferee who would not offer service equal or superior to that provided by the transferor. MMM Holdings, Inc., 4 F.C.C. Rcd. 8243, 8243-44 ¶¶ 6-10 (1989).

62. Provided that the license is not transferred until one year after the initial grantee commences service. *See* 47 C.F.R. § 73.3597.

Included in that amount would be the broadcaster's return of, and on, the cost of undepreciated and nonsalvageable investments made in his station in reliance on the renewal expectancy.

54. In the absence of a fee simple absolute, it is the expectation of an unbroken succession of license renewals that has great economic value. The distinction between ownership and the alienability of rents generated by the right to use a resource was presaged by Oliver Wendell Holmes, who wrote of the confusion between ownership, possession, and conveyancing:

> But what are the rights of ownership? They are substantially the same as those incident to possession. Within the limits prescribed by policy, the owner is allowed to exercise his natural powers over the subject-matter uninterfered with, and is more or less protected in excluding other people from such interference. The owner is allowed to exclude all, and is accountable to no one. The possessor is allowed to exclude all but one, and is accountable to no one but him. The subject of property so large and important are questions of conveyancing, not necessarily or generally dependent on ownership as distinguished from possession.[63]

A broadcaster can have an economic expectation without the security of ownership, and indeed *ownership is irrelevant as long as the broadcaster can transfer to another the value of his economic expectation.* The Commission's creation of a renewal expectancy can be regarded as an explicit recognition of that proposition.[64] Therefore, what matters more than whether a broadcaster has a right of ownership in a frequency is whether he has the right to convey to a third party the expectation of receiving in perpetuity the benefits derivable from the use of that particular frequency.

55. An expected flow of earnings can be freely alienable for value even though its

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63. OLIVER WENDELL HOLMES, THE COMMON LAW 193-94 (1881) (M. Howe ed. 1963).

64. Central Florida Enterprises, Inc. *v.* FCC, 683 F.2d 503, 507 (D.C. Cir. 1982). Judge Laurence Silberman has observed: "The Commission appears to act as if incumbency and the renewal expectancy were a property interest—which it is [*sic*] not." Monroe Communications Corp. *v.* FCC, 900 F.2d 351, 359 (D.C. Cir. 1990) (Silberman, J., concurring).

recipient may lack the absolute right to demand that it be paid. Consider common stock. A shareholder is a residual claimant: he contracts for the right to net cash flows of the corporation.[65] Although a share of stock confers an absolute right of ownership, all that the shareholder has contracted for is an entitlement to the firm's net cash flow; because that contractual right is not a guaranty of payments, it has value (short of the corporation's liquidation) only to the extent that the corporation's assets are expected to earn a positive net cash flow in the future.[66] Even though a broadcaster has a defeasible interest in a frequency during his license term, the expected net cash flow that his station will generate over successive license terms is an asset that can be valued and sold to other persons who are qualified to be licensees.

56. Of course, unlike shareholders, who hold the right to the net cash flows of a corporation for the life of the corporation, a broadcast licensee has no legally enforceable right after its license expires to receive the net cash flows arising from its use of a licensed frequency. In other words, if one buys a station in the secondary market and pays a price that reflects the expected net cash flows for years beyond the term of the current license for the station, he is purchasing an unenforceable expectation, because no private right exists in the broadcast spectrum beyond the end of the current license term. Therefore, if near the end of a license term a broadcast station sells for considerably more than the salvage value of its physical assets, one can infer that the marketplace imputes to that station a capitalized value that reflects its

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65. The term "residual claimant" refers to the shareholders claim to the residual value left after a firm has subtracted from its uncertain inflow of revenues the outflows of payments that reflect the obligations that the firm must pay with certainty. Eugene Fama & Michael C. Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 328 (1983).

66. *See, e.g.*, RICHARD BREALEY & STEWART MYERS, PRINCIPLES OF CORPORATE FINANCE 45-48 (2d ed. 1984).

discounted expected net cash flow computed beyond the end of its current license term and into the indefinite future. In a large city, the capitalized value of that expected net cash flow can be hundreds of millions of dollars.[67] Consequently, the loss of a license through revocation or nonrenewal reduces the value (wealth) of a broadcasting company by an equivalent amount (net of the salvage value of the station's physical assets, such as its real property and equipment).

57. Although purchasing the expected net cash flow of a broadcast station is therefore risky, it cannot be commercially imprudent or else there would be very few voluntary transfers of licenses at significant prices. To the contrary, many such transfers occur. Because the FCC only infrequently revokes a broadcast license or denies renewal of a license,[68] there has arisen the commercial expectation that, in the absence of wrongdoing and so long as a licensee provides "good" service, the licensee may continue to hold his license until he sees fit to dispose of it. In other words, an equilibrium exists in which it is commercially reasonable to buy and sell broadcast stations for prices equivalent to their expected net cash flow extending into the indefinite future, even though the Communications Act clearly grants only a defeasible right to use a frequency during the term of the license. If broadcasters did not expect that they would be permitted to transfer stations at prices equal to the expected net cash flow computed in perpetuity, radio and television stations would sell for far lower prices, as the market value of a station would consist of the expected net cash flow of the station only during the remainder of its current license term. As a matter of simple arithmetic, that amount would be considerably less than the station's expected net cash flow computed in perpetuity; and, of course, at the end

67. *See* RKO General, Inc., 3 F.C.C. Rcd. 5043, 5057 ¶ 2 (1988) (assignment, after expiration of license term, of independent VHF television station in Los Angeles for $314 million).

68. *See, e.g.*, FEDERAL COMMUNICATIONS COMMISSION, ANNUAL REPORT FISCAL YEAR 1986 36–37 (1987).

of the term of the license, the expected net cash flow for the remainder of the license would be zero, such that a station would be worth only the salvage value of its physical assets.

58. The insight that the broadcasting industry is willing to transfer a station at a price equivalent to its expected net cash flow computed in perpetuity in no way depends upon establishing a system of private ownership of the spectrum. Ownership in fee simple absolute is not essential for one to convey an asset's expected net cash flows.[69] When a broadcaster sells his station, he in effect assigns to the new owner an unexpired defeasible use and a lottery ticket. The lottery ticket, of course, is a metaphor for the possibility—or expectation—that the Commission will enter into a new license for the frequency with the assignee. Of course, if that possibility were truly as remote as the chance of winning a lottery, it would have only a slight economic value. But experience indicates that the probability of renewal is appreciably greater than zero.

b. *Asset-Specific Investment*

59. If it were not commercially reasonable for a broadcast licensee to expect to be granted renewal and to be permitted freely to transfer his license to a third party, it would be very risky for the licensee to make investments in his station that (1) had a useful life extending beyond the term of the license and (2) could not be readily salvaged or redeployed by the licensee (as could a personal computer, for example) if the licensee abruptly exited the broadcasting industry. Such investments are *asset-specific* because, as Professor Oliver E. Williamson describes them, they are "durable investments that are undertaken in support of

69. *See* GINSBURG, *supra* note 28, at 60; De Vany, Eckert, Meyers, O'Hara & Scott, *supra* note 28, at 1531–34.

particular transactions, the opportunity cost of which investments is much lower in best alternative uses or by alternative users should the original transactions be prematurely terminated."[70] Professors Paul Milgrom and John Roberts define an asset's degree of specificity to be "the fraction of [the asset's] value that would be lost if it were excluded from its major use."[71]

60. A mundane example of an asset-specific investment is a tenant repainting his apartment at his own expense on the last day of a one-year lease. The tenant will be able to enjoy the benefits derivable from repainting his apartment only if he and his landlord renew their lease. The tenant's investment in repainting his apartment is specific to another asset—namely, the renewed leasehold for the apartment. That investment has no salvage value to the tenant. According to the Milgrom-Roberts measure, the paint job's degree of asset specificity for the

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70. OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 55 (Free Press 1985); *see also* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS (Free Press 1975); OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE (Oxford University Press 1996). For similar discussions of the importance in regulation of cost recovery for asset-specific investments, see J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES 102–09 (Cambridge University Press 1997); JEAN-JACQUES LAFFONT & JEAN TIROLE, A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION 53–127 (MIT Press 1993); DANIEL F. SPULBER, REGULATION AND MARKETS 610 (MIT Press 1989).

Along with Professor Williamson, another early contributor to this body of literature was Professor Victor P. Goldberg. *See* Victor P. Goldberg, *Regulation and Administered Contracts*, 7 BELL J. ECON. 426 (1976); *see also* Victor P. Goldberg, *Relational Exchange: Economics and Complex Contracts*, 23 AM. BEHAVIORAL SCIENTIST 337, 340 (1980), *reprinted in* READINGS IN CONTRACT LAW 16, 18 (Victor P. Goldberg ed., Cambridge University Press 1989). For similar analyses, in the tradition of Professor Goldberg, of asset-specific investment in regulated industries, see Paul L. Joskow & Richard Schmalensee, *Incentive Regulation for Electric Utilities*, 4 YALE J. ON REG. 1, 8–12 (1986); Dennis L. Weisman, *Default Capacity Tariffs: Smoothing the Transitional Regulatory Asymmetries in the Telecommunications Market*, 5 YALE J. ON REG. 149, 157–61 (1988); Glenn Blackmon & Richard Zeckhauser, *Fragile Commitments and the Regulatory Process*, 9 YALE J. ON REG. 73, 76–78 (1992). For a survey of the literature building on Professor Goldberg's analysis, see Keith J. Crocker & Scott E. Masten, *Regulation and Administered Contracts Revisited: Lessons from Transaction-Cost Economics for Public Utility Regulation*, 9 J. REG. ECON. 5 (1996).

For important, early work on the appropriability of asset-specific investment in unregulated markets, see Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978); Benjamin Klein & Keith Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

71. PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 307 (Prentice Hall 1992).

tenant is 1.00. The tenant can derive value from the investment only if he and the landlord renew their contractual relationship.

61. Similarly, a broadcaster makes substantial durable, nonsalvageable investments in support of his licensing transaction with the FCC—investments such as advertising for his station, business relationships with customers (that is, purchasers of advertising time), the development of (or the contractual commitment to buy) long-running programming, and the creation of a good reputation in the community. Naturally, a licensee's propensity to make asset-specific investments in his station increases with the expected duration of the license, just as a commercial tenant's incentive to make long-lived improvements to rented office space increases with the duration of the tenant's lease.[72] Given the relatively short term of a broadcast license, the amount of asset-specific investment that will be made by the broadcaster depends on there being a reasonable expectation that the FCC and the broadcaster will repeat their licensing transaction in smooth succession into the future. By analogy, Professor Pablo T. Spiller and others have shown that the level of investment in long-lived infrastructure undertaken by a regulated (or recently privatized) public utility depends critically on regulatory institutions' having been designed to ensure the credibility of the regulator's commitments that it will not act opportunistically once the utility has placed those nonsalvageable assets into service.[73]

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72. For empirical evidence of the link between contract duration and the incentive to make asset-specific investment, see Professor Paul L. Joskow's research on long-term contracts by which coal mines supply electric utilities with coal. Paul L. Joskow, *Vertical Integration and Long-Term Contracts: The Case of Coal-Burning Electric Generating Plants*, 1 J.L. ECON. & ORG. 33 (1980); Paul L. Joskow, *Contract Duration and Durable Transaction-Specific Investments: The Case of Coal*, 77 AM. ECON. REV. 168 (1987); Paul L. Joskow, *Asset Specificity and the Structure of Vertical Relationships: Empirical Evidence*, 4 J.L. ECON. & ORG. 95 (1988).

73. Pablo T. Spiller, *Institutions and Regulatory Commitment in Utilities' Privatizations*, 2 INDUS. & CORP. CHANGE 387 (1993); Brian Levy & Pablo T. Spiller, *The Institutional Foundations of Regulatory Commitment: A Comparative Analysis of Five Country Studies of Telecommunications Regulation*, 10 J.L. ECON. & ORG. 201 (1994); Shane Greenstein, Susan McMaster & Pablo T. Spiller, *The Effect of Incentive Regulation on Infrastructure Modernization: Local Exchange Companies' Deployment of Digital Technology*, 4 J. ECON. & MGMT. STRATEGY 187 (1995).

62. One can trace to the Radio Act of 1927, and to the following years leading to enactment of the Communications Act of 1934, an awareness by Congress and the courts of the public benefits from encouraging broadcasters to make asset-specific investment in their stations. In 1926, when discussing the appropriate duration of a radio station license under the proposed Radio Act, Representative Davis remarked that "perhaps it was not fair to expect anybody to expend a large amount of money to operate the station for a short period."[74] Similarly, in 1931, the D.C. Circuit remarked: "The installation and maintenance of broadcasting stations involve a very considerable expense. Where a broadcasting station has been constructed and maintained in good faith, it is in the interests of the public and common justice to the owner of the station that its status should not be injuriously affected, except for compelling reasons."[75] Analogously, in 1934, John Bauer, a noted scholar on public utility regulation, wrote, in the *Encyclopaedia of the Social Sciences*, of nonsalvageable investment by public utilities: "Capital is largely embodied in fixed structures which are useless except for their special purposes."[76] In 1947 and again in 1964, the D.C. Circuit emphasized that "valuable rights and investments made in reliance on a license of the Federal Communications Commission should not be destroyed except for the most compelling reasons."[77] In 1982, the conclusion that asset-specific investment by broadcasters serves the public interest was one rationale on which the D.C. Circuit upheld the Commission's establishment of a renewal expectancy for broadcast licensees.[78] In 1988, the

74. *To Regulate Radio Communication: Hearings on H.R. 5589 Before the House Comm. on the Merchant Marine and Fisheries*, 69th Cong., 1st Sess. 25 (1926) (remarks of Rep. Davis).

75. Journal Co. *v.* FCC, 48 F.2d 461, 463 (D.C. Cir. 1931).

76. John Bauer, *Public Utilities: United States and Canada*, *in* 12 ENCYCLOPAEDIA OF THE SOCIAL SCIENCES 677, 680 (Edwin R. A. Seligman & Alvin Johnson eds., Macmillan Co. 1934).

77. Jefferson Radio Co. *v.* FCC, 340 F.2d 781, 783 n.4 (D.C. Cir. 1964) (quoting Churchill Tabernacle *v.* FCC, 160 F.2d 244, 247 (D.C. Cir. 1947)).

78. Central Florida Enterprises, Inc. *v.* FCC, 683 F.2d 503, 507 (D.C. Cir. 1982).

FCC again noted, in a controversial renewal proceeding, the significance of the distinction between asset-specific investment and more readily salvageable or shorter-lived investment.[79]

C. *Recapitulation*

63. The biggest problem with the public ownership argument is that it proves too much. Government ownership of the airwaves stems purely from a legislative decision in 1927 to claim ownership, notwithstanding the prior use of the spectrum by "homesteaders."[80] Some of those spectrum homesteaders challenged the nationalization of the spectrum as an uncompensated taking in violation of the Fifth Amendment; their legal theory was too far ahead of its time, however, and the homesteaders lost.[81] What if Congress were next to decide that it owns the *air* as well? Could the government then demand that all communication traveling through the air conform to rules? That prospect seems ludicrous, but it does not differ fundamentally from the status quo. By what right, after all, did Congress claim control of the broadcast spectrum? To answer that question, one must fall back on the scarcity argument, which Part II already showed to be insufficient to justify retaining the newspaper-television cross-ownership rule.

V. Does the Newspaper-Television Cross-Ownership Rule Serve an Illegitimate Purpose?

64. Spectrum "scarcity," "pervasiveness," and public ownership of the spectrum all fail to provide a logical argument for why, in the presence of general-purpose antitrust statutes, the absolute barrier to entry imposed by the newspaper-television cross-ownership rule is still

79. RKO General, Inc. 3 F.C.C. Rcd. 5057, 5059-60 ¶ 19 (1988).
80. *See* Hazlett, *Rationality of Broadcast Regulation, supra* note 19.
81. White *v.* Johnson, 282 U.S. 367 (1931); Trinity Methodist Church, South *v.* FRC, 62 F.2d 850 (D.C. Cir. 1932), *cert. denied*, 288 U.S. 599 (1933); City of New York *v.* FRC, 36 F.2d 115 (1929), *cert. denied*, 281 U.S. 729 (1930); United States *v.* Gregg, 5 F. Supp. 848 (S.D. Tex. 1934).

necessary today to achieve diversity of viewpoints and economic competition. What, then, explains the longevity of the cross-ownership rule? What is the rule's true purpose? In particular, can one hypothesize an illegitimate purpose that plausibly explains the rule's continued existence, long after media markets have become demonstrably diverse and competitive?

A. *Rent Extraction as an Economic Theory of Regulation*

65. One plausible hypothesis is that the newspaper-television cross-ownership rule facilitates "rent extraction," an economic theory of regulation persuasively advanced in the recent book by Professor Fred S. McChesney.[82] "The overriding lesson of the rent-extraction process," he writes, "is that politicians are interested in any stock of immobile capital or wealth from which they can extract a share."[83] McChesney argues that legislators and regulators maximize their personal welfare by extracting from private citizens a portion of the wealth that those government officials forbear from expropriating altogether. Although private threats to expropriate rents would likely be considered extortion, the government's threats to do so are not prohibited by law (save perhaps by the Takings Clause or the doctrine of unconstitutional conditions). In McChesney's model, the government effects rent extraction through the powers to tax and to regulate. But, as Judge Posner noted long ago in a famous harbinger of McChesney's thesis, taxation *by* regulation is rampant and may be the single most important attribute of regulation.[84]

66. By the early 1970s, legal and economic scholars at the University of Chicago

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82. FRED S. MCCHESNEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION (Harvard University Press 1997).

83. *Id.* at 122.

84. Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22 (1971).

challenged the public interest theory of regulation, traceable to the Progressive Movement and the New Deal, which posited that regulation served the interests of consumers.[85] According to Professors Stigler, Becker, Peltzman, Posner and other Chicagoans, regulation served the private interests of regulated firms by effecting a form of government-sponsored cartelization. The function of regulation was to create economic rents (supracompetitive returns) that could not be earned in the absence of government-imposed restrictions on market entry. The modern theory of economic regulation asserted that government does not regulate platonically "in the public interest" but rather supplies regulation to interest groups who demand it and pay for it with political currency of one sort or another—be it votes, contributions, or public accolades. To the Chicago School, *rent creation* was thus the practical, if unstated, function of regulation. Within the Chicago School analysis of regulation, as well as in the Virginia School of public choice theory, "rent-seeking behavior" connotes the various activities that interest groups undertake to receive such income transfers though the legislative or regulatory process.[86]

67. Professor McChesney, however, notes that regulation can do more than create rents through an extralegal form of exchange between the state and a private interest group. Regulation can also *extract* rents—either rents previously created through such government largess or rents created privately (such as through innovation).[87] He writes:

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85. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. 335 (1974); Sam Peltzman, *Towards a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Gary Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983).

86. *See generally* DENNIS C. MUELLER, PUBLIC CHOICE II (Cambridge University Press 1989); JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (University of Michigan Press 1962); MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (Harvard University Press 1965).

87. MCCHESNEY, *supra* note 90, at 23–32.

> In his pathbreaking article on rent creation via regulation, Stigler opined that creating new rents was the primary regulatory activity of politicians. That is, of course, an empirical claim for which no supporting evidence has been presented. Nor do I have any compelling evidence to the contrary. Yet despite the centrality of rent creation in the economic literature, there is good reason to think that selling wealth protection explains more of what is going on in the United States.[88]

Viewed in those terms, a major consequence of regulation, including the FCC's newspaper-television cross-ownership rule, may be to extract private rents. Typical forms of rent extraction are political threats to reduce prices or raise costs. The private firm that is the target of the threatened rent extraction thus faces an incentive to pay some form of consideration to politicians to prevent the imposition of the new regulatory regime. Political contributions are a principal way in which rents can be extracted, but other means include honoraria and in-kind gifts. An agency such as the FCC would have different methods to extract rents from broadcasters, as in the case of mandatory amounts of children's programming or "free" air time to political candidates.[89]

B. *The Newspaper-Television Cross-Ownership Rule as a Device for Rent Extraction*

68. A broadcast license is thought by many to be a government largess upon which the FCC may freely attach regulatory burdens that extract a share of the economic rents generated by the broadcaster's use of that license—by, in effect, taxing through regulation the discounted expected net cash flow of a licensed station. So viewed, a broadcast license is a classic example of a publicly created rent that is subsequently vulnerable to extraction by factions powerful enough to influence the regulatory prerogatives of the FCC or Congress. That view

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88. *Id.* at 164.
89. *See* BEVIER, *supra* note 28.

ignores, however, that any economic rent that a broadcaster enjoys is at least as likely to have been *privately* created. Moreover, given the economies of scale noted earlier with regard to program production, a broadcaster will have quasi-rents that also are vulnerable to appropriation. If a broadcaster is forced to forfeit his license through revocation or denial of renewal, his ability to salvage specialized investments made in the station is limited if he is not permitted to own other media of mass communications in the same geographic market. A broadcaster faces the risk that his speech may provoke attempts to expropriate, through the license renewal process, the quasi-rents and privately created economic rents associated with the operation of his station. Lesser forms of rent extraction take the form of "taxation by regulation" through requirements for "issue-responsive programming," children's programming, "free" air time for federal political candidates, and the like.

69. The newspaper-television cross-ownership rule may seem at first to typify "structural" regulation of the broadcasting industry entitled to only a lesser level of judicial review under the First Amendment.[90] That assessment is too simplistic, however. Even though the newspaper-television cross-ownership rule does not outwardly resemble an attempt by the government to censor, the rule can restrict a broadcaster's editorial discretion by increasing the proportion of the station's assets at risk if the FCC chooses not to renew the station's license. The rent extraction model suggest that, *because* a structural rule receives a light-handed review from a court, the government would prefer it over a content-based rule as the means by which to extract rents from licensees.

70. It is possible for the Commission to extract programming concessions from

90. *See generally* Geoffrey Stone, *Content-Neutral Restrictions*, 54 U. CHI. L. REV. 46 (1987).

broadcasters in return for withdrawing the threat to deny renewal of the broadcaster's license. Outright denials of renewal have been rare in the Commission's history, and revocations of licenses have been rarer still. Those facts should not be surprising, for they are entirely consistent with a model of regulation in which the FCC seldom expropriates the entire value of a station, but instead, with greater frequency, extracts a portion of the value of numerous stations by directing that certain kinds of programming be aired and other kinds of programming be suppressed.[91]

71. A rent-extraction model of the newspaper-television cross-ownership rule provides a plausible explanation for *why* the rule exists. Denial of license renewal is the FCC's credible threat of expropriation. The Commission's power to extract (rather than expropriate entirely) a lesser portion of the broadcaster's rents arises from the FCC's myriad policies, including the newspaper-television cross-ownership rule, whose purposes stray far afield from the consumer welfare maximization of antitrust law and are instead goals, purportedly "in the public interest," that are so nebulous as to be nonfalsifiable. Such policies enable parties, both public and private, to use the coercive prerogatives of the government to extract rents from broadcasters.

72. The newspaper-television cross-ownership rule contributes to the FCC's ability to extract rents in the following respect. The rule has the unacknowledged, but entirely predictable, effect of increasing a broadcaster's risk of not recovering the undepreciated portion of his asset-specific investment at the end of his license term. If the broadcaster had no amount

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91. Note how that result dovetails with the recognized principle in takings jurisprudence that small regulatory takings may go uncompensated: "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." Pennsylvania Coal Co. *v.* Mahon, 260 U.S. 393, 413 (1922) (Holmes, J.).

of undepreciated asset-specific investment at the end of his license term, then the threat of expropriation would be meaningless, as exit from the local television market would cost the broadcaster nothing. The consequences to the broadcaster of not accommodating those powerful enough to influence the Commission would be that the broadcaster would simply walk away from his station, with no economic loss. It follows that the government's ability to extract rents in that circumstance would be nil. In contrast, as soon as the broadcaster makes long-lived, asset-specific investment in the station, he becomes vulnerable to rent expropriation and rent extraction. To avoid the risk that he will suffer total expropriation of (1) the entire quasi-rent associated with the asset-specific investment in his station and (2) the privately created economic rents earned by that station, the broadcaster may find it expedient to acquiesce, through compliant or obsequious programming choices, to the FCC's extraction of a lesser percentage of those quasi-rents or economic rents.

73. One would expect the broadcaster to take steps to mitigate this risk of "rent extraction by regulation." One mitigation strategy would be for the broadcaster simply to refrain from making any long-lived, asset-specific investments in his television station. As a practical matter, however, that option could be infeasible, as it would likely reduce the attractiveness of the station in the eyes of consumers, and thus diminish the station's economic value. An alternative strategy would entail exploiting economies of scope with other media—which, of course, the broadcaster already would have an incentive to do independently of rent extraction considerations. If the broadcaster's investments in editorial staff, advertising sales, and other activities also can be used for newspaper publishing, then the broadcaster could achieve the usual

economies of scope.[92] But he could also reap an additional benefit: His cross-ownership of the local newspaper would mean that, if the FCC denied renewal of or revoked his broadcast license, the broadcaster-publisher would not suffer as great an economic loss of his investment due to nonsalvageability as if he were solely a broadcaster with no local publishing activity. In other words, the economies of scope between operating a television station and publishing a local newspaper would make possible a kind of mitigation of harm. In that respect, cross-ownership reduces for the broadcaster the expected cost associated with the government's ability to engage in rent extraction through the regulatory process.

74. If a television broadcaster could mitigate the risk of rent extraction by achieving economies of scope with a daily newspaper, what would be the regulator's countermove? It would be, and is, the FCC's newspaper-television cross-ownership rule. Rent extraction by the FCC or Congress (at the behest of powerful factions) is simply another commercial risk that a broadcaster faces, a risk whose expected value the broadcaster has some ability to reduce through preventive behavior. The newspaper-television cross-ownership rule blocks one important kind of defensive effort that a broadcaster might undertake to reduce that regulatory risk. The rule is like a prohibition on buying fire insurance in a fire-prone canyon. By blocking the broadcaster's attainment of economies of scope across newspaper publishing and television broadcasting in a given locale, the rule prevents a broadcaster from converting some of his asset-specific investment into non-asset-specific investment. The rule prevents the broadcaster from

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92. *See, e.g.*, DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 70–72, 81–82 (Harper Collins, 2d ed. 1994); JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 19–20 (MIT Press 1988); WILLIAM J. BAUMOL, JOHN C. PANZAR & ROBERT D. WILLIG, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 71 (Harcourt Brace Jovanovich 1982; rev. ed. 1988).

reducing the degree of asset specificity of his investment in his television station and thus reducing the magnitude of his potential loss if he is subjected to extractive regulatory policies. The rule holds hostage to regulation a larger relative share of the broadcaster's total investment in his station. Consequently, the newspaper-television cross-ownership rule preserves the ability of the FCC and Congress to extract some of the quasi-rents and privately created economic rents derivable from the broadcaster's operation of his television station.

75. If there were no newspaper-television cross-ownership rule, the reduction of regulatory risk through the joint ownership of a television station and a daily newspaper would give a broadcaster greater freedom from political threats to extract rents through regulatory burdens imposed on the broadcaster by the FCC. That reduction in regulatory risk would serve the interest of freedom. It would give the broadcaster greater insulation from retaliation if his news reporting and commentary offended politicians or powerful private factions. Economic analysis would therefore lead one to predict that a newspaper-television pair grandfathered under the newspaper-television cross-ownership rule would address more controversial subjects, and report on them more forcefully, than would a broadcaster forbidden by the rule from owning a daily newspaper in the same city. Economic analysis would further lead one to predict that, because it had achieved a way to mitigate the risk of rent extraction by regulation, a newspaper-television pair would make a greater level of long-lived asset-specific investment than would a broadcaster forbidden by the current rule from owning a daily newspaper in the same city.

76. Such economic inferences speak directly to something no less important than the freedom of electronic speech and the robustness of the broadcast press. A sophisticated economic model of broadcast regulation, which candidly takes into account the propensity of government

to engage in rent extraction, provides powerful support for the abolition of the newspaper-television cross-ownership rule.

C. *The Enduring Tradition of Content Control in American Broadcast Regulation*

77. The rent-extraction theory of regulation is consistent with the enduring tradition of content control in American broadcast regulation. The desire to control content has been present in the federal regulation of broadcasting since the earliest days of the Federal Radio Commission. In *Near* v. *Minnesota*, the Supreme Court in 1931 invalidated a Minnesota law that permitted the state's courts to suppress the publication of any "malicious, scandalous or defamatory newspaper."[93] *Near* expanded the definition of "prior restraint" to include cases enjoining an individual from future speech on the basis of past speech. *Near* stands in stark contrast to the *Brinkley*[94] and *Shuler*[95] cases of the same era. In *Brinkley*, the Federal Radio Commission denied renewal of the license of an individual who regularly broadcast radio programs discussing medical problems that listeners described to him by letter. The FRC found the program "inimical to the public health and safety" and thus "not in the public interest."[96] The D.C. Circuit upheld the FRC's action and stated that the agency "is necessarily called upon to consider the character and quality of the service to be rendered" and that it thus had an undoubted right to look at past performance.[97]

78. The result in *Brinkley* comports with *Shuler*, in which the FRC ordered a radio

93. 283 U.S. 697, 706, 722-23 (1931).

94. KFKB Broadcasting *v.* FRC, 47 F.2d 670 (D.C. Cir. 1931) (*Brinkley*).

95. Trinity Methodist Church, South *v.* FRC, 62 F.2d 850 (D.C. Cir. 1932), *cert. denied*, 288 U.S. 599 (1933) (*Shuler*). The definitive analyses of those cases, upon which the discussion here relies, are KRATTENMAKER & POWE, *supra* note 28, at 24-28, and POWE, *supra* note 28, at 13-27.

96. *KFKB Broadcasting*, 47 F.2d at 671.

97. *Id.* at 672.